ANNUAL REPORT 1968

File

Computer Sciences Corporation

Canada

COMPUTER SCIENCES CORPORATION
ANNUAL REPORT

For the Year Ended March 29, 1968

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FROM THE PRESIDENT

TO THE SHAREHOLDERS OF COMPUTER SCIENCES CORPORATION:

During the fiscal year ended March 29, 1968, the Company again achieved record financial results while continuing to expand the scope of its operations into new and promising areas of activity. Sheer growth during the year can be expressed in terms of importantly large increases in revenues, profit, capitalization, number of employees and expansion of facilities.

Total revenues were $53,386,000, amounting to a 38% increase over the record $38,796,000 for the year before. Net earnings from operations were $2,462,000, or 57 cents per share on 4,306,762 shares, the average number outstanding during the year. This represents a 45% increase over fiscal 1967 operating earnings of $1,704,000, or 41 cents per share on the 4,190,616 then average outstanding shares, adjusted to reflect the two-for-one stock split of June 7, 1967. These results exclude 1968 net income of $842,000, or 20 cents per share, attributable to the sale of an interest in the COMPUTAX system.

While the year's financial results were certainly satisfying, they were somewhat below expectations, due primarily to the marked slowdown during the second half in research and development funding by government agencies with which the Company had contracts or pending support roles. This condition, stemming chiefly from the diversion of government funds to support hostilities in the Far East, is forecast to improve with time, and a cessation of the war in Vietnam would have a pronounced and rapid beneficial effect on the government sector of the Company's business.

As in preceding years, the growth of the Company during fiscal 1968 was attributable nearly in its entirety to internal expansion of activities which the Company has traditionally carried on and to internal development of services and products which are natural extensions of the Company's past activities. Total employment grew to over 3,000 from some 2,300 the year before, while the opening of several new offices and performance centers extended CSC's total facilities to 25 U.S. cities and six foreign countries.

Late in the year, the Company announced the formation of Computer Sciences Institute, through which CSC will offer indoctrination and courses of instruction in the planning and application of computer-based systems. The Institute's extensive program of courses and seminars will include those particularly aimed at familiarizing top management with the capabilities and implications of computers, and with the effective use of the computer as a key tool of business modernization and control.

In response to customer interest, the Company formed Computer Sciences Leasing Company to provide third-party leasing services to users of computers and associated equipment. This activity will allow

greater flexibility in the undertaking by CSC of large systems responsibilities, which increasingly in the future are expected to require the providing of both software and hardware. Conversely, the Company is extremely well suited to offer leasing services by reason of its strong qualifications in the areas of systems analysis and programming, which most industry analysts believe will be instrumental in the long-range success of leasing services firms.

Continued emphasis was placed on proprietary developments during the year. COMPUTICKET, the Company's remote instant ticketing system for sports and entertainment events, was completed to the point of system test and demonstration by year's end. Several important COMPUTICKET distribution agreements were negotiated with key outlets for the system, and an encouraging number of event promoters have endorsed the COMPUTICKET system. The system is planned to become operational in both Los Angeles and New York during the second half of the current fiscal year and will be a growing and important contributor to revenues and earnings thereafter.

Other proprietary efforts were directed toward the completion of several new program packages for sale to computer users, notably those in the banking community. The Company's efforts to develop this market have been rewarded with very encouraging results, the benefits of which will be financially meaningful this year and increasingly so in future periods.

Meanwhile, the previously developed COMPUTAX system had a very successful processing season during Spring 1968, and COMPUTAX Services, Inc., in which Computer Sciences holds a significant equity position, expects for the first time to be profitable for its fiscal year ending September 30, 1968. Forecasts indicate that COMPUTAX will continue its very positive earnings trend, and CSC management is quite optimistic respecting the benefits that a growing COMPUTAX success will have on the Company.

A new proprietary effort, which was planned during the year and announced after year's end, will become by far the Company's largest commitment to date in terms of both the funding required and earnings potential. The new activity is to be based on the establishment of a nationwide network of computers, eventually some twenty in number, through which the Company will offer a communications-based information and computation facility to business, industry, and the Government throughout the country. This activity has been one of keen interest to your management since the pioneering efforts of CSC resulted in the development almost five years ago of the first operational system for remote use of computers. Our fundamentally strong and growing expertise in both communications and

computer technologies, coupled with nearly unmistakable indications that important market support for the intended services is near at hand, gives CSC management confidence that timing is now excellent for a large-scale commitment to this immensely important business activity. Details of the plan for this undertaking are being finalized at this time and will be announced shortly.

In order to properly fund the Company's anticipated investments in proprietary developments and to finance the continued growth in its communications and computer services business, common stock was sold through a successful rights offering to shareholders during the last quarter of fiscal 1968. The proceeds of the sale, equalling some $16 million, allowed the Company to retire all debt as of year's end and to plan its future business on the basis of a conservative capital structure.

In May 1968 the Company announced that its management had reached a tentative agreement in principle with the management of The Western Union Telegraph Company for a merger of the two organizations. Terms of the proposed exchange of stock and other aspects of the contemplated merger will be detailed in proxy material and merger agreements under current preparation, which in due course will be distributed to stockholders. Our annual meeting will be scheduled this year at a later date than usual to permit consideration during the meeting of the charter amendment required by the merger and a vote thereon by shareholders, if negotiations for the merger are successfully completed. The proposed transaction would also be subject to approval by Western Union stockholders and various state and federal agencies, including the Federal Communications Commission, whose approval would be sought after favorable action by shareholders of both companies.

Management is grateful for the support of the employees, shareholders, and customers of the Company, and particularly recognizes the contribution of the technical staff to the continued success of Computer Sciences Corporation.

Fletcher Jones, President and Chairman

CONSOLIDATED BALANCE SHEET

ASSETS

CURRENT ASSETS:	March 29, 1968	March 31, 1967 (As restated — Note 1)
Cash and bank acceptances due April 15, 1968	$ 1,636,000	$ 176,000
Marketable securities and commercial paper — at cost; quoted market prices $6,292,000	6,206,000	—
Notes and accounts receivable:		
Trade accounts receivable, including $4,482,000 (1968) and $2,055,000 (1967) from the United States Government	$ 6,035,000	$ 3,722,000
Other accounts receivable	948,000	294,000
Note receivable	265,000	399,000
	$ 7,248,000	$ 4,415,000
Recoverable amounts under contracts in progress (Note 1)	8,669,000	5,632,000
Prepaid expenses and other assets	449,000	220,000
TOTAL CURRENT ASSETS	$24,208,000	$10,443,000
INVESTMENTS AND OTHER ASSETS (Note 2):		
Proprietary programs and systems in progress:		
COMPUTICKET— at cost	$ 1,072,000	$ 149,000
Other — at cost, less accumulated amortization of $463,000 (1968) and $83,000 (1967)	2,170,000	422,000
	$ 3,242,000	$ 571,000
Investment in and note receivable from COMPUTAX Services, Inc.	569,000	629,000
Miscellaneous	103,000	41,000
	$ 3,914,000	$ 1,241,000
EQUIPMENT AND LEASEHOLD IMPROVEMENTS — at cost, less accumulated depreciation and amortization of $1,541,000 (1968) and $1,050,000 (1967) (Note 3)	4,144,000	1,597,000
EXCESS OF COST OF BUSINESS ACQUIRED OVER RELATED NET ASSETS (Note 1)	1,586,000	1,586,000
	$33,852,000	$14,867,000

LIABILITIES AND STOCKHOLDERS' EQUITY

	March 29, 1968	March 31, 1967 (As restated — Note 1)
CURRENT LIABILITIES:		
Notes payable to bank	$ —	$ 2,250,000
Accounts payable and accrued expenses	1,967,000	1,779,000
Accrued payrolls, payroll taxes and amounts withheld from employees	2,909,000	2,045,000
Federal taxes on income	573,000	669,000
Current portion of long-term note	—	92,000
TOTAL CURRENT LIABILITIES	$ 5,449,000	$ 6,835,000
DEFERRED FEDERAL TAXES ON INCOME (Notes 2 and 3)	1,785,000	273,000
DEFERRED INCOME (Note 2)	1,624,000	—
NOTE PAYABLE, less current portion	—	344,000
COMMITMENTS AND CONTINGENT LIABILITIES (Note 4)		
STOCKHOLDERS' EQUITY (Notes 1, 6 and 7):		
Preferred stock, par value $1.00 a share, authorized 1,000,000 shares — none issued		
Common stock, par value $.10 a share, authorized 10,000,000 shares, issued 4,793,827 shares (1968) and 4,291,192 shares (1967)	$ 479,000	$ 429,000
Capital surplus	18,976,000	2,414,000
Earnings retained in the business	7,434,000	4,572,000
	$26,889,000	$ 7,415,000
Less treasury stock — at cost (53,442 shares)	1,895,000	—
	$24,994,000	$ 7,415,000
	$33,852,000	$14,867,000

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF NET EARNINGS

	Year ended March 29, 1968	Year ended March 31, 1967 (As restated — Note 1)
REVENUES (Note 1):		
Service revenues	$53,214,000	$38,645,000
Interest, dividend and other income	172,000	151,000
	$53,386,000	$38,796,000
COSTS AND EXPENSES:		
Cost of services	$43,070,000	$31,583,000
General and administrative	4,575,000	3,692,000
Depreciation and amortization	998,000	321,000
Interest	354,000	120,000
	$48,997,000	$35,716,000
EARNINGS BEFORE FEDERAL TAXES ON INCOME AND EXTRAORDINARY ITEM	$ 4,389,000	$ 3,080,000
FEDERAL TAXES ON INCOME (Notes 2 and 3):		
Current	$ 567,000	$ 1,189,000
Deferred	1,532,000	239,000
Investment credit	(172,000)	(52,000)
	$ 1,927,000	$ 1,376,000
EARNINGS BEFORE EXTRAORDINARY ITEM	$ 2,462,000	$ 1,704,000
GAIN ON SALE OF INVESTMENT IN COMPUTAX SERVICES, INC., net of income taxes of $281,000 (Note 2)	842,000	—
NET EARNINGS	$ 3,304,000	$ 1,704,000
PER SHARE OF COMMON STOCK on average shares outstanding:		
Earnings before extraordinary item	$.57	$.41
Gain on sale of investment in COMPUTAX Services, Inc.	.20	—
Net earnings	$.77	$.41

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CAPITAL SURPLUS AND EARNINGS RETAINED IN THE BUSINESS

	Year ended March 29, 1968	Year ended March 31, 1967
CAPITAL SURPLUS:		
Balance at beginning of year	$ 2,414,000	$ 2,170,000
Excess of proceeds received from stock rights offering over par value of 413,055 shares issued	16,149,000	—
Excess of proceeds received from exercise of stock options over par value of 89,580 shares issued (1968) and 70,900 shares issued (1967)	413,000	244,000
Balance at end of year	$18,976,000	$ 2,414,000
EARNINGS RETAINED IN THE BUSINESS:		
Balance at beginning of year	$ 4,572,000	$ 3,037,000
Net earnings for year	3,304,000	1,704,000
Cash dividends paid (per share — $.10 and $.04 for the fiscal years 1968 and 1967)	(442,000)	(169,000)
Balance at end of year	$ 7,434,000	$ 4,572,000

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF SOURCE AND APPLICATION OF FUNDS

	Year ended March 29, 1968	Year ended March 31, 1967 (As restated — Note 1)
FUNDS PROVIDED BY:		
Net earnings	$ 3,304,000	$ 1,704,000
Depreciation and amortization	998,000	321,000
Proceeds from exercise of stock options	422,000	251,000
Proceeds from rights offering	16,190,000	—
Deferred gain on sale of investment in COMPUTAX Services, Inc.	1,624,000	—
Reduction in:		
Cash	—	995,000
Increases in:		
Notes payable to bank	—	2,238,000
Other current liabilities	1,013,000	709,000
Federal taxes on income	1,416,000	—
	$24,967,000	$ 6,218,000
FUNDS USED FOR:		
Purchased equipment and leasehold improvements, net	$ 3,065,000	$ 998,000
Dividends paid	442,000	169,000
Purchase of treasury stock	1,895,000	—
Reduction in:		
Notes payable to bank	2,250,000	—
Federal taxes on income	—	359,000
Miscellaneous items	628,000	272,000
Increases in:		
Cash and marketable securities	7,666,000	—
Notes and accounts receivable	2,833,000	960,000
Recoverable amounts under contracts in progress	3,037,000	2,905,000
Proprietary programs and systems	3,151,000	555,000
	$24,967,000	$ 6,218,000

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year ended March 29, 1968

Note 1—Principles of consolidation, accounting policies and restatement:

The accompanying financial statements consolidate the accounts of the Company, its wholly owned subsidiaries, and a majority-owned domestic subsidiary, COMPUTICKET Corporation. All significant intercompany transactions have been eliminated.

A majority-owned foreign subsidiary has not been consolidated. The Company carries this investment at equity in the net assets of the foreign subsidiary.

The excess of cost of business acquired over related net assets is related to a subsidiary acquired in prior years and will not be amortized so long as this asset has continuing value.

The Company and its subsidiaries provide services under cost based, time and materials, and fixed price contracts. Income is generally recorded on the basis of the estimated percentage of completion of services rendered.

Pending resolution of litigation in connection with the acquisition of a subsidiary during the year ended March 31, 1967, the Company in its financial statements for that year included its investment in this subsidiary at equity in net assets and included the results of operations of the subsidiary separately in the Consolidated Statement of Net Earnings. Pursuant to the terms of a settlement, the Company purchased 53,442 (70%) of the shares originally issued in the acquisition at a cost of $1,895,000. The financial statements for the year ended March 31, 1967 have been restated to fully consolidate the accounts of this subsidiary. The restatement had no effect on net earnings of the Company.

Note 2—Investments and other assets:

The Company has an investment of $219,000 (38%) in COMPUTAX Services, Inc. and a note receivable of $350,000 due from COMPUTAX Corporation, a wholly owned subsidiary of COMPUTAX Services, Inc.

In August, 1967, the Company sold a portion of its investment in COMPUTAX Services, Inc. As the purchaser may require the Company to repurchase the stock at any time during the period, July 24, 1969 to July 24, 1973, the gain on this sale to the extent of the repurchase price has been deferred. The Company will recognize this additional gain, $1,624,000 less related taxes of $420,000, when the repurchase obligation expires or is relinquished.

It is the Company's policy to accumulate during the development period and thereafter to amortize the costs of each proprietary program or system including the applicable technical and marketing efforts on the basis of estimated revenues or over a period of up to five years, whichever provides the earlier amortization. An unamortized balance is expensed (1) at the time a program or system is abandoned, or (2) to the extent that projected revenues will be less than the amortization expense. Amortization expense amounted to $480,000 and $54,000 for the years ended March 29, 1968 and March 31, 1967, respectively.

The costs applicable to proprietary programs and systems in progress are deducted for federal income tax purposes in the year in which they are incurred. Deferred federal taxes on income have been provided

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

for the difference between reporting deferred development costs for tax purposes and reporting for financial statement purposes.

Note 3—Equipment and leasehold improvements:

The cost of equipment and leasehold improvements is depreciated over the estimated useful lives of the assets from the dates of acquisition on the straight-line method. Accelerated methods of depreciation are used for purposes of determining taxable income and deferred taxes have been provided for the difference between reporting for tax and financial purposes. The estimated lives, costs, and accumulated depreciation and amortization are:

	Estimated lives	March 29, 1968	March 31, 1967
Computer	10 years	$2,326,000	$ —
Furniture and equipment	3 to 10 years	2,026,000	1,509,000
Transportation equipment	3 to 10 years	762,000	771,000
Leasehold improvements	Life of lease	571,000	367,000
		$5,685,000	$2,647,000
Less accumulated depreciation and amortization		1,541,000	1,050,000
		$4,144,000	$1,597,000

The computer is used by the Company in the performance of a contract which has a shorter term than the estimated economic life of the computer. In the opinion of management, the computer will be sold or re-leased at the end of the contract term at amounts sufficient to recover the remaining investment.

It is the Company's policy to recognize the full amount of the investment tax credit on qualified purchases and leases of equipment as a credit against federal taxes on income in the year of acquisition.

Note 4—Commitments and contingent liabilities:

Minimum fixed rentals for the next five years required under leases for real property in effect at March 29, 1968 are, beginning with the fiscal year 1969: $1,375,000, $1,167,000, $1,105,000, $973,000, and $931,000.

The expiration dates of the leases range from April, 1968 to June, 1978, and minimum fixed rentals thereunder for the period from March 29, 1968 to June 1978 aggregate $9,696,000. In one lease, operating expenses including taxes and insurance are paid by the Company, and estimated amounts of sublease revenues have been deducted in arriving at rental expenses included above.

The Company has filed suits against former COMPUTAX franchise dealers for accounts receivable of $62,000 due as the result of services performed in prior years. These dealers have cross-complained and filed damage suits, claiming breach of contract, totaling $4,552,000. It is management's opinion and that of its legal counsel that the suits filed by the dealers are substantially without merit, and liability to the Company, if any, is not material to the Company's financial condition.

In connection with its examination of the fiscal year ended April 1, 1966, the Internal Revenue Service has proposed a tax deficiency of $667,000. In the opinion of the Company and its legal counsel, any amount ultimately found to be owing will not materially affect the financial condition of the Company and no provision

for this item has been made in the financial statements.

Service revenues relative to government contracts are subject to review under the provision of the Renegotiation Act of 1951 as amended. No refund as a result of this review is anticipated.

Note 5—Pension and stock purchase plans:

Substantially all employees are eligible for the Company's pension plan. The total pension expense for the year was $317,000. The Company's policy is to fund pension cost, accrued on the unit credit method, through both Company and employee contributions. The actuarially computed value of vested benefits for the plan (including all past service costs) is less than the total of the pension fund.

In accordance with provisions of the employees' stock purchase plan, the Company is committed to contribute an amount equal to 50% of the amount contributed by its employees. An employee's contribution is generally limited to 6% of his base compensation. Stock of the Company is purchased monthly on the open market and is credited to an employee's account at the full purchase price. For the year ended March 29, 1968, the cost to the Company was $290,000.

The pension plan and stock purchase plan are qualified plans under the Internal Revenue Code.

Note 6—Stockholders' equity:

At March 29, 1968, 273,900 shares of common stock were reserved for the granting of future options. Options may be granted to officers and key technical and managerial employees of the Company and its subsidiaries at prices equal to fair market value at date of grant. Options granted prior to January 1, 1964, are exercisable in cumulative annual installments after two and through six years from the date of grant, and expire seven years from date of grant. Options granted subsequent to December 31, 1963, are exercisable in cumulative annual installments commencing after two years from date of grant until expiration five years from date of grant.

At March 29, 1968, options for the purchase of 252,620 shares, of which 10,315 were exercisable, of the Company's common stock were outstanding at prices from $2.50 to $54.31 a share.

During the year, options for the purchase of 89,580 shares of the Company's stock were exercised at prices from $2.50 to $13.22 a share.

In June 1967, the Company split its common stock on a two-for-one basis. The 5,000,000 authorized shares of $.20 par value were increased to 10,000,000 shares with a par value of $.10 a share and the outstanding shares increased to 4,243,200.

Note 7—Subsequent event :

In June, 1968, the Boards of Directors of Computer Sciences Corporation and The Western Union Telegraph Company agreed in principle to a plan of merger whereby Computer Sciences Corporation would acquire all the outstanding common and preferred stocks of Western Union in exchange for new series of preferred stocks of Computer Sciences Corporation. Consummation of the merger is dependent upon approvals by the stockholders of both companies and various regulatory agencies. It is impossible to present meaningful pro forma consolidated financial statements at this time which give effect to the proposed merger, as there are a number of significant accounting, tax and similar technical matters remaining to be resolved.

AUDITORS' REPORT

Board of Directors
Computer Sciences Corporation
Los Angeles, California

We have examined the accompanying consolidated balance sheet of Computer Sciences Corporation and subsidiaries as of March 29, 1968, and the related statements of capital surplus, earnings retained in the business and net earnings and the statement of source and application of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Computer Sciences Corporation and subsidiaries at March 29, 1968, and the consolidated results of their operations and the source and application of funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Touche, Ross, Bailey & Smart
Certified Public Accountants

Los Angeles, California
June 6, 1968

BOARD OF DIRECTORS

Fletcher Jones, Chairman
William R. Hoover
D. K. Layser
Alvin E. Nashman
Roy Nutt
Geo. T. Scharffenberger
James W. Z. Taylor

OFFICERS

Fletcher Jones, President
D. K. Layser, Vice President, Finance
Roy Nutt, Vice President
James W. Z. Taylor, Secretary

CORPORATE OFFICES

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Los Angeles, California 90067

PRINCIPAL OPERATING UNITS

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650 North Sepulveda Boulevard
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Communications & Systems, Incorporated
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Brussels 5, Belgium

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Los Angeles, California 90014

Chase Manhattan Bank
Trust Department
One Chase Manhattan Plaza
New York, New York 10015

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Corporate Trust Division
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Corporate Trust Department
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New York, New York 10015

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